

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Date 4/20/99

Contact Person:

Surname

Telephone Number:

In Reference to:

OP:E:EO:T:2

Date:

SEP 11 1998

DO:

EIN:

Dear Applicant:

This is in regard to your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code.

You were established to promote the use of [REDACTED], referred to as the [REDACTED] in some of the materials you submitted. The [REDACTED] You expect to donate any net proceeds you have after the payment of your own expenses and those of the developer, title holder and manufacturer of the system, to certain section 501(c)(3) recognized charities.

You have a contractual agreement with [REDACTED] and its parent, [REDACTED] to manufacture your [REDACTED] and establish the needed support system. [REDACTED] is a high tech company which pioneered the development of [REDACTED] in this country. It has already designed and copyrighted a [REDACTED], which appears to be similar to the [REDACTED] and system you intend to establish. In fact, in your Business Plan you recognize that the [REDACTED] can become the [REDACTED] and that the [REDACTED] system and the [REDACTED] are somewhat compatible. [REDACTED] is responsible for the development and the production of the [REDACTED]. You, on the other hand, are to promote the issuance of [REDACTED] and play a guiding role in the development of [REDACTED] and necessary support system. In addition to the above listed responsibilities, your agreement with [REDACTED] indicates that your primary responsibility is to obtain tax exempt bond financing, commercial sponsorship and other grants.

Your contractual agreement with [REDACTED] provides that all rights to the technology, which you are to finance, will remain with [REDACTED] and you are to purchase a non-exclusive license for use of the technology. You are to pay a royalty or licensing fee

Re: [REDACTED]

to [REDACTED] of \$ [REDACTED] for each [REDACTED] and \$ [REDACTED] for each usage fee collected. The agreement represents that [REDACTED] has a financial or corporate interest in you, and that no officer, director, employee or stockholder of [REDACTED] or its parent currently has any financial or personal interest in you. You do not have the right to extend the application of this technology to other uses or other target groups without agreement of and actual development of such other uses by [REDACTED]. It is expected that all expenses incurred by [REDACTED] in the production of [REDACTED] shall be paid through initial grant monies and bond sale proceeds. The agreement specifies that [REDACTED] will be fully reimbursed for the initial production costs it incurs.

You intend to initially market the [REDACTED] to older Americans in cooperation with [REDACTED] (hereinafter referred to as [REDACTED]). It appears that [REDACTED], at least to members of [REDACTED], will be between \$ [REDACTED] and \$ [REDACTED]. A usage fee, estimated to be \$ [REDACTED] per event will be charged to [REDACTED] and these fees will be distributed to the hospital, [REDACTED] and yourself. According to your Business Plan the hospital is to receive \$ [REDACTED] will receive \$ [REDACTED] and you will receive \$ [REDACTED] for each usage. Your Business Plan indicates that [REDACTED] must pay an annual renewal fee of \$ [REDACTED]. Of this amount \$ [REDACTED] will be distributed to [REDACTED] to cover its costs, \$ [REDACTED] to [REDACTED] and \$ [REDACTED] to yourself. In your Business Plan you indicate that the price to nonmembers of [REDACTED] will be \$ [REDACTED]. You have represented that overall the revenue earned by [REDACTED] will be limited to a reasonable profit over its costs. Your agreement breaks down the estimated costs of [REDACTED] and distributing it to be \$ [REDACTED]. Your Business Plan also indicates that you will rely on some funding from "sponsors" [REDACTED].

Although the support system requires hospitals and ambulances to purchase spacial equipment to read the [REDACTED] it is not clear who the manufacturer and/or vendor of this equipment is to be.

Section 501(a) of the Code provides, in part, for the exemption from federal income tax of organizations described in section 501(c)(3) of the Code.

Section 501(c)(3) of the Code describes organizations organized and operated exclusively for religious, charitable and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more purposes specified in that section. If an organization does not meet either the organizational or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. It includes the promotion of health.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3) even though it has certain religious purposes, its property is held in common and its profits do not inure to the benefit of individual members of the organization.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), Ct.D. 1650, C.B. 1945, 375, the Supreme Court of the United States held that the presence of a nonexempt purpose, if more than insubstantial, would destroy tax exempt status as a charitable organization.

In Old Dominion Box Co. v. United States, 477 F.2d. 344 (4th Cir. 1973) cert. denied 413 U.S. 910 (1973), the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

Harding Hospital, Inc. v. United States, 505 F2d 1068 (1974), holds that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In EST of Hawaii v. Commissioner, 71 TC 1067 (1971) exemption was denied to an organization engaged in training, seminars and lectures, in the areas of intrapersonal awareness and communication. Such activities were conducted under licensing arrangements with for-profit organizations. The activity served the commercial purposes of the for-profit corporations.

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), the Tax Court concluded that an organization that raised funds for charity by conducting bingo games in a bar owned by the organization's directors had the substantial private purpose of making food and beverage sales for the benefit of the bar's owner. On this basis, the Court concluded that the organization could not qualify for exemption under section 501(c)(3).

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36 (1989), the Court concluded that the petitioner was not described in section 501(c)(3) of the Code. The petitioner was organized for the purpose of providing continuing medical education to physicians. To this end, it took physicians on three week tours throughout the world. The petitioner shared offices with a for-profit travel agency which was controlled by the petitioner's principal officer. It made all its travel arrangements through the agency. The Court found that a substantial purpose of the petitioner was benefitting the for-profit travel agency. It concluded that "when a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of (section) 501(c)(3), even if it furthers other exempt purposes."

It is incumbent upon an organization seeking a ruling recognizing its tax exempt status to carry the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact. See Harding Hospital, Inc. v. United States, supra.

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Generally, when the activities of an organization seeking exemption under section 501(c)(3) of the Code either directly or indirectly, (see EST of Hawaii v. Commissioner, supra, P.L.L. Scholarship Fund v. Commissioner, supra and International Post Graduate Medical Fund v. Commissioner, supra) benefit private individuals or a for-profit corporation to more than an insubstantial degree, the organization will not qualify for recognition of exemption under section 501(c)(3). See Better Business Bureau v. United States, supra, and section 1.501(c)(3)-1(d)(ii) of the regulations. Furthermore, operating for the benefit of private individuals is a substantial nonexempt purpose. See Old Dominion Box Co. v. United States, supra.

The information submitted establishes that your activities primarily center on advertising and promoting the sale of a ██████████. In addition, you will be seeking funding to pay ██████████ expenses in developing this system through corporate sponsorship agreements, tax exempt bond funding and other grants. The developer, ██████████, will grant you a non-exclusive license to market this product for a fee. You expect to collect sufficient funds to completely reimburse ██████████ of ██████████ for the expenses it will incur in establishing ██████████ and its network. The for-profit corporation will also receive royalty fees from you, fees based on ██████████. Furthermore, ownership of the involved technology will remain in the hands of the for-profit corporation and it has the right to license this product or a similar product based on the same technology to other parties. Furthermore, you intend to pay ██████████, ██████████, for its assistance in promoting the ██████████.

Based on the information you have submitted we have concluded that your activities benefit private interests to more than an insubstantial degree. You state that you are merely refunding the expenses incurred by ██████████ in producing the ██████████ and that this agreement was entered into at arms length. However, it is clear ██████████ will incur little or no expense in developing ██████████ and ██████████, holds the technology and can exploit it as desired. In addition, it will receive additional financial benefit whenever ██████████ is used and upon ██████████. Furthermore, ██████████ will also financially benefit by reason of this project. The fact that you will distribute a portion or all of your net profits to recognized charitable organizations does not change the conclusion that you are operating directly for the private benefit of ██████████.

In this letter we have not given any consideration as to whether your involvement in the distribution and advertising of

Re: [REDACTED]

[REDACTED] is similar to a trade or business and could also preclude exemption under section 501(c)(3) of the Code. Generally, an organization that provides ordinary business services for exempt health care organizations does not promote health in a charitable manner.

Accordingly, we have concluded that you do not qualify for recognition of exemption under section 501(c)(3) of the Code. Contributions to you are not deductible under section 170 of the Code. You are required to file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 30 days from the date of this letter. You also have the right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Procedures.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the U.S. Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

cc: [REDACTED]

Sincerely yours,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2

cc: [REDACTED]

cc: [REDACTED]

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